

APPENDIX A



**MCI Communications
Corporation**

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Jonathan B. Sallet
Chief Policy Counsel

March 2, 1998

William Kennard
Chairman
Federal Communications Commission
Washington, D.C. 20554

Dear Mr. Chairman:

On February 26, 1998, you requested in a publicly-released letter that MCI respond to unwarranted and unfounded allegations by the United States Telephone Association to the effect that MCI specifically, and long distance carriers generally, have not passed along to the benefit of their customers the modest access charge savings that have resulted from the orders issued by the Commission in May of 1997.

We have shown the Commission, in fact, that MCI's long distance rates have dropped further and faster than those access reductions and that MCI customers have received nearly half a billion dollars of additional savings since July 1, 1997. That information has been provided in a series of meetings between MCI and the Commission since November, 1997, including, on one occasion, a meeting between senior MCI executives, including myself, you and your staff. In all of those discussions, the Commission never suggested to us that our numbers or our conclusions were in error. Indeed, only a few weeks ago, you told an audience of consumer advocates that:

"[L]ong distance rates fell 5.3% between January 1996 and November 1997. Long distance prices are now at the lowest they have ever been.¹

By contrast, the incumbent telephone companies increased their revenues for access charges, boosting their revenues and earnings yet again in 1997, despite the Commission's Price Cap and Access Reform orders. They completely misunderstand the way that a competitive market, unlike these monopolies, anticipates change. The incumbents do not seem to be able to grasp, for example, that MCI, with the

¹ FCC Chairman William Kennard to the National Association of State Utility Consumer Advocates, February 9, 1998.

introduction of its 5 Cents Sunday program and other initiatives, passed through savings well in excess of access charge savings to every MCI customer even before January access restructuring came into effect. That is because competitors see creative opportunity in price reductions where monopolies see only legal requirements.

Because we have already presented information to the Commission and because the record is so clear, we are -- three days ahead of your requested deadline -- placing on the public record detailed data demonstrating that:

- (1) A year after the release of the May orders, MCI customers will be receiving more in savings than the Commission itself predicted when the Access Reform and Price Cap orders were released;
- (2) MCI has passed along all access charge savings resulting from the May orders (\$756 million) -- and an additional \$467 million in savings to boot. Not only have rates have fallen further than access reductions, they have fallen in advance of access charge reductions;
- (3) Both consumers and business customers have benefited from the pass-through of access charge savings; and
- (4) The creation of presubscribed interexchange carrier charges (PICCs), which shift some per minute access charges to per line fees, and the universal service charges impose real costs in 1998 on MCI in excess of the access charge savings.

In other words, any suggestion that MCI is profiting from access charge restructuring or from the implementation of new charges is false.

The basic problem remains -- not the implementation of access charge restructuring -- but the unjustified level of the remaining access charges themselves.

The Commission's May orders cut about \$1.5 billion out of the approximately \$30 billion in interstate and intrastate per/minute and end-user access charges. But much more needs to be done. On the federal level alone, switched access charges continue to exceed costs by \$7 billion.

Last year, the Commission promised that competitive pressures caused by new entrants into the local exchange business would drive access prices down. But the so-called "market-based" approach to access reform has failed, the victim of court rulings and litigation by incumbent local exchange carriers. Where there is no market, there can be no "market-based" pressure to lower access charges.

In MCI's view, the current, inflated level of access charges is:

- (1) illegal, because it violates the clear command of the Telecommunications Act of 1996 that all subsidies be explicit;
- (2) economically irrational, because it maintains a system in which local monopolies charge appreciably more for termination of long-distance traffic than for local traffic, even though the work performed by the local company is exactly the same;² and
- (3) anticompetitive, because it gives the local companies an additional reason to block the opening of local markets (in order to safeguard the artificial level of access charges) and an additional means of distorting long-distance markets (through price squeezes).

For these reasons, and armed with the evidence that the competitive long distance industry has once again provided benefits above and beyond Commission-ordered access charge reductions, the Commission should immediately turn its attention to the joint petition of the International Communications Association, National Retail Federation and Consumer Federation of America to re-open the question of prescribing access rates to levels that would be found in a competitive market. Where markets fail, the Commission must act.

Finally, MCI is disappointed at the suggestion that it has not informed its customers that they have received the benefits of lower access charges. As Commission staff knows, MCI asked the incumbent local exchange carriers to enclose the following statement in the February bills sent to MCI residential customers:

As part of the implementation of the Act, the Commission ordered local phone companies to reduce the amount of money they charge to all long distance carriers for originating and terminating long distance calls. As a result, MCI has lowered its long distance rates, passing through to its customers more than twice the amount it is saving in these cost reductions. Competition. It works.

Unfortunately, not all the Bell Operating Companies, with whom we contract to do our billing, allowed the language to be used. Enclosed is information detailing the response of each Bell Operating Company to our attempt to send the above-quoted

² For example, in New York, MCI pays \$0.051 in interstate access, but only \$0.0287 for local interconnection. In Michigan, we pay \$0.042 for interstate access, but \$0.0259 for local.

message. In addition, as readers of the Washington Post may recall, MCI published the text of this notice on February 4 and 11, 1998.

In this light, we believe firmly that information that we are providing to customers about new line charges on their bill is fair and accurate. It is true that MCI and other long distance carriers are facing a new set of costs -- a flat per customer line charge that we pay to the incumbent local exchange carriers and universal service costs that come to us in two ways: (1) directly from the universal service fund administrator; and (2) through the universal service obligations of incumbent local exchange carriers that are passed through entirely to the long distance industry. It is also true that decisions about how to charge our customers to recover these costs are ours and ours alone. We have recently reviewed our customer service materials to ensure that this distinction is correctly stated.

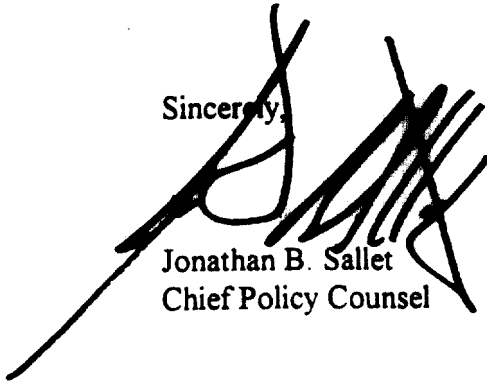
In fact, of course, efforts to provide customers with earlier notice of the details of new fees to be implemented in January, 1998 were hampered by the fact that the Commission itself did not finalize the level of universal service fees until December 16, 1997, less than a month before the new fees were to go into effect and too late to permit inclusion of information in the January billing cycle.

Moreover, we continue to be dismayed that the Commission allowed the restructuring to go into effect without any apparent recognition of the practical problems it caused. While MCI has no quarrel with the policy decision underlying the creation of PICCs -- that non-usage sensitive access charges should not be recovered in per minute fees -- the plain fact is that the long distance carriers are in a poor position to recover per line fees. Unlike the local telephone companies, who have for several years recovered subscriber line charges, the long distance industry lacks (1) the data to accurately recover such fees, and (2) the ability to charge per line fees to customers who make no long distance calls in a given month (between 25-30% of MCI customers make no long distance calls in any given month). And even if these problems did not exist, at a minimum it adds millions of dollars in unnecessary costs to MCI and other carriers to attempt to recover such amounts on behalf of the local exchange carriers. The Commission direct the local exchange carriers to recover the PICCs directly from end users -- matching the task and the beneficiary.

Chairman William Kennard
March 2, 1998 --5

Mr. Chairman, we reject the suggestion that the Telecommunications Act of 1996 has failed. It can succeed. But it can succeed only if economic rationality is brought to telephony. That is why the Commission must move quickly to (i) place the work of collecting fees for the local companies on the local telephone companies, (ii) cut access charges to cost, and (iii) immediately grant MCI's emergency petition, filed on February 24, 1998, so that, in the interim, the basic requirements of the present system are in place.

Sincerely,



Jonathan B. Sallet
Chief Policy Counsel

Enclosures

Invoice Message History

February (Residential Only)

- 1/6 Invoice message sent to LECs for "pre-approval."
- 1/8 SBC/Pac Bell view message as "competitive." Requests edits.
- 1/9 Bell Atlantic/Nynex requests substantiation to access reduction claim. Approves original message.
- 1/14 Bell South requests substantiation to access reduction claim. Rejects message.
- 1/14 US West approves original message.
- 1/14 GTE rejects message. Disagrees with interpretation of telecom reform. Requests edits. Message runs in March.
- 1/14 Ameritech rejects message as competitive and in conflict B&C contract.

Invoice Message Text

February

Original Message Residential Only (Ran as is in Direct Remit, Bell Atlantic/Nynex, and US West)

The 1996 Telecommunications Act laid out a plan to open local phone markets to competition. As part of the implementation of the Act, the FCC ordered local phone companies to reduce the amount of money they charge to all long distance carriers for originating and terminating long distance calls. As a result, MCI has lowered its long distance rates, passing through to its customers more than twice the amount it is saving in these cost reductions. Competition. It works.

Revised SBC/Pac Bell Message

As part of the implementation of the Telecommunications Act, the FCC ordered phone companies to reduce the amount of money they charge to all long distance carriers for originating and terminating long distance calls. As a result, MCI has lowered its long distance rates, passing through to its customers more than twice the amount it is saving in these cost reductions.

Revised GTE Message (Ran in March)

As part of the implementation of the Telecommunications Act, there has been a reduction in the amount of money charged to all long distance carriers for originating and terminating long distance calls. As a result, MCI has lowered its long distance rates, passing through to its customers more than twice the amount it is saving in these cost reductions. Competition. It works.



Access Reform The Impact on MCI

March 2, 1998

Methodology

- All comparisons are 2H 97 and 1H 98 vs 1H 97 unless otherwise noted
- Industry statistics based on FCC filings and earnings reports
- MCI information based on internal information

May 97 Access Ruling Yielded a Modest Decline in Costs to IXC's

	Industry Impact (M)*			MCI Impact (M)		
	2H 97	1H 98	Total	2H 97	1H 98	Total
Reduced Access Charges	(\$800)	(\$2,859)	(\$3,659)	(\$165)	(\$591)	(\$756)
Implemented New Changes	0	2,515	2,515	0	480	480
Net Impact to IXCs	<u>(\$800)</u>	<u>(\$344)</u>	<u>(\$1,144)</u>	<u>(\$165)</u>	<u>(\$111)</u>	<u>(\$275)</u>

* Estimates Based on:

LEC Tariff Review Plan, FCC Investigation Orders, FCC Estimates

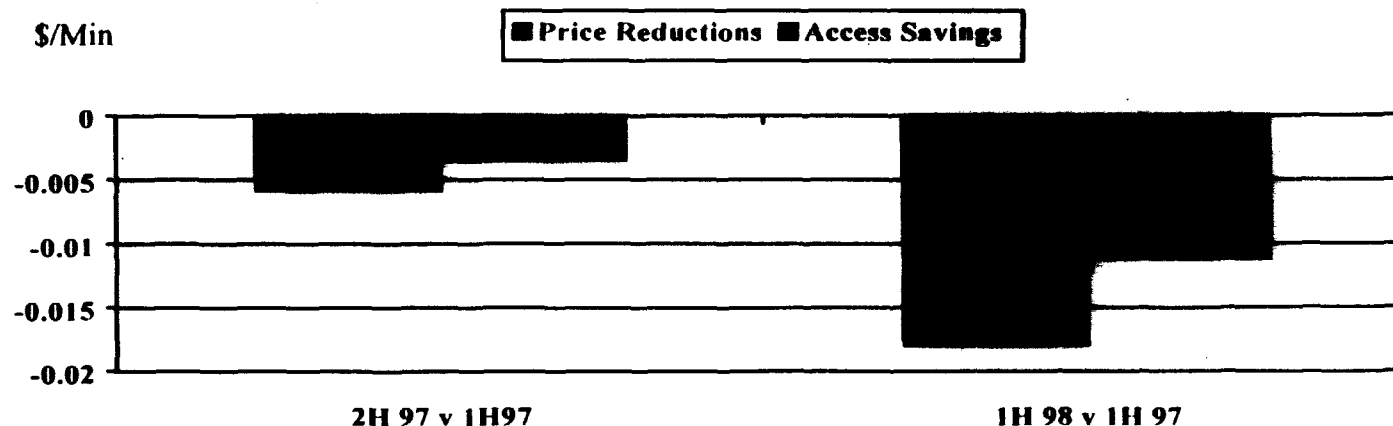
MCI Costs Decreased \$275M

	2H 97 vs 1H 97		1H 98 vs 1H 97		Total		Total
	<u>Consumer</u>	<u>Business</u>	<u>Consumer</u>	<u>Business</u>	<u>Consumer</u>	<u>Business</u>	
Access Reduction	(\$56)	(\$109)	(\$207)	(\$385)	(\$263)	(\$493)	(\$756)
PICC Fees	0	0	69	112	69	112	180
USF Fees	0	0	107	193	107	193	300
Total	<u>(\$56)</u>	<u>(\$109)</u>	<u>(\$31)</u>	<u>(\$80)</u>	<u>(\$87)</u>	<u>(\$188)</u>	<u>(\$275)</u>

MCI Passed Through Access Charge Reductions to End Users

Actions:

- | | | |
|--|------------------------|--------------|
| • \$.05 on Sunday | Access Savings | (\$756M) |
| • New Product | Total Price Reductions | <u>1,223</u> |
| • 20% Cash Back for SB | Extra Customer Savings | \$467 |
| • Customer Migration to
Lower Rate Products | | |
| • Contract renegotiations | | |



Two Line Family in Charleston

- Young couple with two lines, college friends and relatives living throughout the South.
- Current long distance bill is \$60/month under a \$0.10/minute calling plan

FCC Prediction

- Under FCC proposal, family's savings on total bill (local and long distance) is about 4% (\$2.50).

MCI Customer

- Under MCI One, MCI's most popular plan, family's savings is about 11% (\$6.45).

Funeral Parlor - Anywhere, USA

- Funeral parlor has three lines, mainly for incoming calls. Owner makes 15 minutes of long distance calls/month.

FCC Prediction

- Current LD bill is \$7
- Under FCC proposal, total bill increases by about \$13.00/month.

MCI Customer

- Under MCI rates and Per Line PICC recovery of \$2.75 per line, bill increases by \$12.

Travel Agency in Sioux Falls, SD

- Three phone lines for two agents. Each agent makes about 2.5 hours of long distance calls per day.
- Total long distance bill (all lines) is about \$790 per month, about \$930 including local.

FCC Forecast

- Total bill under FCC proposal declines by about \$52, or about 6%.

MCI Customer

- Under MCI One with Per Line PICC recovery, bill increases by only \$11.25 (1.6%).
- With 20% MCI One rebate, bill declines by \$135 (18%).

Senior Citizen in Miami

- Calls grandchildren in California for 10 minutes every other week.
- No calling plan, long distance bill is about \$4.00 per month.

FCC Forecast

- Under FCC proposal, local bill is unchanged, long distance bill falls by about 8%.

MCI Customer

- With 5 Sundays and by timing her calls, long distance bill decreases by 17-48%.
- If 50% calling off peak and 50% on Sunday, bill declines by 17%.
- If all calling on Sunday, bill declines by 48%.

Industry Rate Decline Trend Accelerates in 2H 1997

2H 97 Industry Rate Decline	1,436
2H 97 Industry Access Savings	<u>(800)</u>
2H 97 Industry Extra Customer Savings	<u>\$636</u>

\$1.80 Savings per \$1 of Access

Source: Earnings Reports and Industry Analyst Report

This Reality was Recognized by the FCC

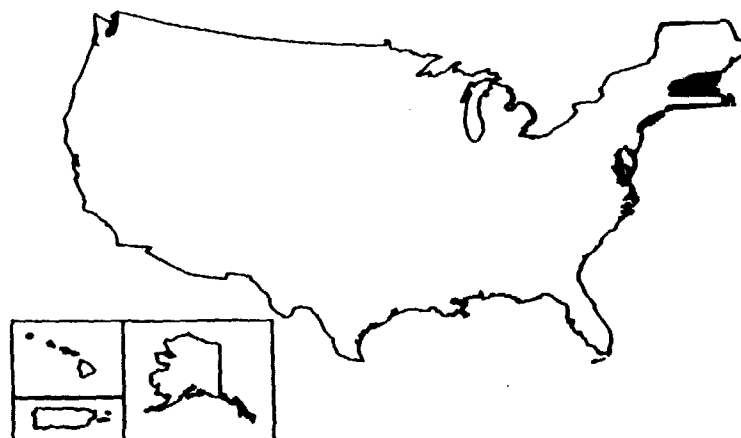
*“Long distance rates fell 5.3%
between January 96 and November
97. Long distance prices are now at
the lowest they have ever been.”*

FCC Chairman William Kennard
Speech to National Association of
State Utility Consumer Advocates
February 9, 1998

Access Reductions have Resulted in Lower Prices



Access Savings



So new charges must be recovered

MCI's Recovery Method for PICC and USF Charges Varied by Market Segment

	<u>Consumer</u>	<u>Small Business</u>	<u>Large Business</u>
PICC	\$1.07 Per Account	Tiered % of revenue structure moving to \$2.75 per line	\$2.75 Per Line
USF	Recovery to begin 7/1/98	5% of Revenue	4.4% of Revenue

MCI Expects to Under Recover New Charges by \$160M in 1H 1998

	<u>USF & PICC Charges</u>	<u>USF & PICC Recovery</u>	<u>Net</u>
Consumer	(\$176)	\$69	(\$107)
Business	<u>(305)</u>	<u>252</u>	<u>(53)</u>
Total	<u>(\$480)</u>	<u>\$321</u>	<u>(\$160)</u>

Summary & Implications

- 1) MCI savings passed to customers have exceeded access reductions by \$467M.
- 2) MCI will under recover PICC/USF by over \$200M in 1998.
(\$160M in 1st half alone)
- 3) The real costs to MCI are going up and are scheduled to go up even more.
- 4) MCI rates should reflect both the nature (per line) and amount of its costs.
- 5) The problem remains with the \$30B in access charges.
They are:
 - Illegal: Telecom Act bars implicit subsidies
 - Anti-competitive: They close the local market and distort the long distance market
 - Economically Irrational: A minute is a minute

A Minute Is A Minute. However...

Conversation Minutes

Local Interconnection*

Cents

- New York Telephone 2.87
- Michigan Bell 2.59

Interstate Access

Cents

- New York Telephone 5.1
- Michigan Bell 4.2

*Local interconnection rates include a per-minute equivalent of the unbundled local loop rate

FCC Must Make Fundamental Changes to Access

- Prescribe access rates to forward-looking cost
 - CFA, NRF, ICA Petition
- Require ILECs to collect PICC directly from end users
- Eliminate distinction between primary and non-primary residential lines
- Require ILECs to make IXC federal universal service contributions explicit, including that portion billed to IXCs through interstate access charges

CERTIFICATE OF SERVICE

I, John E. Ferguson III, do hereby certify that copies of the foregoing Reply Comments of MCI in the Matter of Tariffs Implementing Access Charge Reform were sent, on this 30th day of March, 1998, via first-class mail, postage pre-paid, to the following:

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Washington, DC 20554

Comm. Harold Furchtgott-Roth**
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, DC 20554

Commissioner Michael Powell**
Federal Communications Commission
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Commissioner Gloria Tristani**
Federal Communications Commission
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